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No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1984

VALERIA REED and MARCELLA ROULDAND
Co-Executors of the Estate of Veronica
Hancher, deceased

Petitioners-Appellant

v.

UNITED STATES OF AMERICA

Respondent-Appellee

Petition For Writ of Certiorari to
the United States Court of Appeals
for the Seventh Circuit.

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QUESTIONS PRESENTED FOR REVIEW BY PETITIONER FOR CERTIORARI

The first question presented for review is the Constitutionality of retro-active legislation. The statute in question is the 1978 Technical Amendment to Section 2035(b) of the Federal Estate Tax law which was signed into law by the President on November 6, 1978, and carried an effective date back to January 1, 1977. The amendment provided that in the case of gifts made within 3 years of death which required the filing of a gift tax return (i.e. gifts which exceeded the annual gift tax exclusion of $3000) the entire amount of the gift would be part of the deceased donor's taxable estate for Federal Estate tax purposes. Prior to the 1978 amendment, Section 2035 of the Tax Reform Act of 1976 provided that gifts made within 3 years of the donor's death would be included in his taxable estate with the exception of "any gift excludable in computing taxable gifts by reason of Section 2503(b) (relating to $3000 annual exclusion for purposes of the gift tax). . ."

In reliance on the 1976 Act Veronica Hancher in February, 1978, made gifts of approximately $6300 to each of her 7 children. Veronica died December 2, 1978. Her estate contends that it is entitled to deduct the $3000 annual exclusion from each gift and that only the excess over $3000 should be included in the taxable estate because the retro-active 1978 Amendment violates the due process clause of the 5th Amendment to the United States Constitution.

The government contends that even though the 1978 Amendment was passed some 9 months after the gifts were made, the entire amount of the gifts (and not just the excess over $3000) should be included in the deceased donor's taxable estate because the 1978 Act was made retro-active.

The second question presented for review is whether the court should examine the facts and circumstances surrounding the passage of the 1978 retro-active amendment to determine whether Congress intended only

to make a technical or clarifying amendment to the 1976 Act or whether it intended to make a substantive change in the law. Petitioner contends the circumstances indicate Congress was under the mistaken belief that the 1976 Act was ambiguous and required clarification at the time it passed the 1978 clarifying amendment and that the Court should not have held that it was the intent of Congress to make a substantive change in the law under the guise of a technical or clarifying amendment.

The final question concerns the Constitutionality of a second amendment passed in 1979 to the same statute. After the retro-active 1978 amendment was passed, Congress realized the hardship which it created on those who had made gifts in reliance on the 1976 Act and passed the 1979 amendment which allowed those donors who made gifts during the calendar year 1977 the option of deducting the $3000 and required only the excess over $3000 to be included in the deceased donor's taxable estate. The 1979 amendment did not provide

relief for the 1978 donors who made gifts prior to the enactment of the 1978 Act on November 6, 1978. The Plaintiff contends the classification which gave relief to the 1977 donors but not to the 1978 donors is arbitrary and unreasonable and in violation of the due process clause of the 5th Amendment of the United States Constitution.

PARTIES

Valeria Reed and Marcella Rouland, Co-Executors of the Estate of Veroncia Hancher, Deceased, Plaintiffs. United States of America, Defendant.

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REFERENCE TO OFFICIAL REPORTS

The Appeals Court number is 83-3156 in the Circuit Court of Appeals for the Seventh Circuit. No official report number and page has been assigned.

GROUNDS FOR JURISDICTION

The Federal Courts have jurisdiction for the recovery of any Internal Revenue tax alleged to have been erroneously or illegally collected under Title 28 U.S.C. Sec. 1346(a); Title 26 U.S.C. Sec. 7422 and Title 26 U.S.C. Sec. 6532.

The jurisdiction of this Court is invoked pursuant to 28 USCS §1254. The judgment sought to be reviewed is that of the United States Court of Appeals for the Seventh Circuit entered August 24, 1984.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

Fifth Amendment to United States Constitution:

> "No person shall . . . be deprived of life, liberty, or property, without due process of law; . . ."

Section 2035 of the Internal Revenue Code (26 U.S.C. 2035) showing the 1976 law with the 1978 and 1979 amendments App. 1

The Report of the Senate Finance Committee explaining the reason for the 1979 Amendment excerpt App. 10

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STATEMENT OF THE CASE

This case was filed in the United States District Court for the Central District of Illinois by the Executors of the Estate of Veronica Hancher against the United States of America based on a claim for refund of Federal Estate tax pursuant

to jurisdiction authorized by 28 U.S. C. 1346(a)(1).

Veronica Hancher made a gift of approximately $6300 to each of her seven children on February 21, 1978, and at the time the gifts were made Section 2035 of the Federal Estate Tax law provided that gifts made within three years of death were includable in the decedent's taxable estate except,

> "(2) any gift excludable in computing taxable gifts by reason of Section 2503(b) (relating to $3000 annual exclusion for purposes of the gift tax) determined with out regard to Section 2513(a)."

On November 2, 1978 the President signed into law the 1978 Technical Amendment to Section 2035(b) which changed the exception to read as follows:

> "(2)to any gift to a donee made during a calendar year if the decedent was not required by Section 6019 to file any gift tax return for such year with respect to gifts to such donee."[1]

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1. The text of Sec. 2035 as adopted in 1976 and the 1978 and 1979 Amendments appears at Appendix 1 .

The effect of this amendment was that if the gift required the filing of a gift tax return, i.e. it was over $3000, then the entire amount of the gift must be included in the deceased donor's taxable estate and not just the excess over $3000. This amendment was included in the omnibus 1978 Revenue Act under the Section labled "Technical and Clarifying" amendments and was made retro-active to January 1, 1977.1

After Veronica Hancher's death on December 2, 1978 the executors filed the Federal Estate Tax return for her estate, listed the gift to each of the 7 children and deducted the sum of $3000 from each gift and included the excess as part of her taxable estate. The Internal Revenue Service audit of the return disallowed the $3000 exemption and taxed the entire $6300 of each gift which resulted in an additional tax of approximately $8,000. The executors paid the additional tax and

1. A chronological statement showing the dates of passage, effective dates of the Amendments and the date of Veronica's gifts appears in Appendix 2

filed a claim for refund and after waiting the required six months filed this suit in the District Court. While the case was pending the United States Court of Appeals for the First Circuit handed down its opinion in Ceppi v. Commissioner 698 F 2d 17 (Cert. denied 51 U.S.L.W. 3833 June 13, 1983). The facts in the Ceppi case are almost identical to the facts in this case and the same statutes are involved. The District Court cited the Ceppi decision and disallowed the claim for refund (Appendix 24-29) and the Circuit Court of Appeals for the Seventh Circuit affirmed the ruling of the trial court in the opinion which appears at p. 11-23 of the Appendix.

ARGUMENT

THE UNCONSTITUTIONALITY OF THE RETRO-ACTIVE EFFECTIVE DATE OF 1978 TECHNICAL AMENDMENT

The construction of the 1978 Amendment by the Appeals Court amounted to a substantative change in the law. When Mrs. Hancher made the gifts the law provided for a $3000 exemption per donee and nine months after

she made the gifts the law retro-actively took away the exemption and taxed that which was not taxable at the time the gifts were made. The inherent unfairness of retro-active legislation of this nature is obvious and the issue is whether it can be reconciled with the concept of due process of law required by the Fifth Amendment.

The facts in Untermyer v. Anderson 276 U.S. 440, 72 L ed 645, 48 S Ct 353 are similar to the facts in this case. That case involved the retro-active application of the gift tax law. Untermyer made the gifts in May of 1924 and the bill was signed into law June 2nd 1924 but was made retro-active to January 1, 1924. This court held the retro-active application of the tax was arbitrary and invalid under the Fifth Amendment.

> "And, further that so far as applicable to bona fide gifts not made in anticipation of death and fully consummated prior to June 2, 1924, these provisions are arbitrary and invalid under the due process

clause of the 5th Amendment." (June 2, 1924, was the date the President signed the bill into law.)

Untermyer v. Anderson 72 Led 647

Untermyer was followed by Blodgett v. Holden 275 U.S. 142, 72 L ed 206 which involved the same statute and held:

> "so far as the Revenue Act of 1924 undertakes to impose a tax because of the gifts made during January, 1924, it is arbitrary and invalid under the due process clause of the Fifth Amendment."
>
> Blodgett v. Holden 72 Led 647

The Appeals Court distinguished this case from the Untermyer and Blodgett cases on the basis that Untermyer involved a completely new tax and not a mere change in an existing tax and cited U.S. v. Darusmont 449 U.S. 292 and Milliken v. U.S. 283 U.S. 15. Both of those cases involved retro-active changes in tax rates only. Petitioners concede there is substantial authority upholding retro-active changes in tax rates expecially for income taxes. Those cases hold that a mere retro-active change in the income tax rate (usually to the first of the calendar year) does not

violate the due process clause because it affects only the measure or amount of the tax and does not involve the retro-active taxation of that which was not taxed before.

In citing the Darusmont and Milliken cases as authority for its ruling the Appeals Court failed to recognize the difference between a retro-active change in the rate of tax and the retro-active taxation of a gift tax exemption which was not taxable at the time the gift was made. The retro-active application of tax rate changes to the first of the calendar year can be justified in the interest of fairness as well as for administrative purposes. However, the same reasoning does not hold for retro-active changes in gift tax exemptions which play an important part in estate planning including the making of once-in-a-lifetime irrevocable gifts in reliance on the law in effect at the time the gifts are made.

This Court in the Darusmont case which was an income tax case distinguished

the Untermyer and Blodgett cases as follows:

> "These, however, are gift tax cases, and the gifts in question were made and completely vested before the enactment of the taxing statute. We do not regard them as authority with respect to any retro-active feature of a federal income tax."
>
> U.S. v. Darusmont 449 U.S. 292, 101 S Ct 549, 66 L ed 2d 513 at 519.

In Milliken v. Anderson which involved a change in the Federal Estate Tax rate this court said:

> "This court has held the taxation of gifts made, and completely vested beyond recall, before the passage of any statute taxing them, to be so palpably arbitrary and unreasonable (21) as to infringe the due process clause. Nichols v. Coolidge, 274 U.S. 531, 543, 71 L ed 1184, 1192, 52 A.L.R. 1081, 47 S Ct 710, supra; Untermyer v. Anderson, 276 U.S. 440, 72 L ed 645, 48 S Ct 353; Coolidge v. Long, 282 U.S. 582, ante, 562, 51 S Ct decided February 24, 1931."
>
> Milliken v. Anderson 75 Led 814

The present case involves the retro-active taxation of that which was not subject to taxation prior to the passage of the 1978 amendment, namely the $3000

exemption. In this respect the present case is much closer to the facts in the Untermyer and Blodgett cases than those which merely involve retro-active rate changes.

Is is respectfully submitted that this Court which approved of the Untermyer ruling as recently as the Darusmont case in 1981 take jurisdiction of this case for the purpose of reaffirming the constitutional principles of the Untermyer case. The decision sought to be reviewed in this case as well aslanguage which appears in the decisions of other courts tend to narrow the ruling in the Untermyer case to the point where any kind of retro-active tax legislation is permissable under the Due Process clause.[1] The sound reasoning

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1. Estate of Ceppi 698 F2d 17 at 21 "But Milliken's attempt to distinguish Untermyer is not completely convincing, and numerous lower courts have narrowly interpreted or questioned Untermyer in the light of the Milliken decision." Citing Westwick v. Commissioner 636 F2d 291 at 292; Buttke v. Commissioner 625 F2d 202 at 203. Sidney v. Commissioner 273 F2d 928 at 932 "If Untermyer remains authority at all it is only for the particular situation of a wholly new type of tax there under consideration."

and basic fairness of the principles set forth in the Untermyer case should, in the interest of Constitutional government, be reaffirmed by this court.

THE APPEALS COURT SHOULD HAVE ADOPTED A CONSTRUCTION WHICH WOULD HAVE AVOIDED THE CONSTITUTIONAL QUESTION

In examining the circumstances surrounding the passage of the 1978 amendment it is noted that the amendment appears in the 1978 Revenue Act under the section titled "Technical Amendments."[1] This point was emphasized by the Defendant in its Memorandum of Law which it filed in the District Court.[2] The Defendant concedes in its memorandum that the 1978 amendment "was in the nature of a clarification, as opposed to a change in the law." The Defendant's memorandum points out that the heading of the amendment itself was "Clarification of the $3000 Annual Exclusion From the Rule Including in Gross Estate

1. See excerpt from this Sec. of the 1978 Revenue Act at Appendix 4

2. Appendix 5

Transfers Within 3 Years of Death." Defendant goes on to state that "these labels are proper tools for inferring legislative intent" and "as such, they are persuasive indicators that Congress intended the 1978 Amendment to correct or clarify its 1976 action in a manner consistent with its legislative intent."

The fact that Congress referred to the amendment as a "Technical" and "clarifying" amendment indicates it believed the 1976 Act was ambiguous. It has since been established there was no ambiguity in the 1976 Act. The Ceppi case, supra, which involved the same factual situation and the same statutes was first heard by the Tax Court[1] which held the 1976 Act was ambiguous. The Circuit Court of Appeals for the First Circuit reversed that portion of the Tax Court's ruling and held the 1976 Act was not only unambiguous but did in fact enact the "subtraction out" theory and that the

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1. Estate of Jane B. Ceppi 78 T.C. No. 23, Dec. 38, 826

1976 Congress intended that the $3000 exemption should be allowed.[1] The Court cited the staff Report of the Joint Committee on Taxation[2] prepared shortly after the enactment of the 1976 Act and a number of law review Articles written after the passage of the 1976 Act to support its ruling that the 1976 Act embraced the subtraction theory.

In addition to those authorities Petitioners refer to two publications by the Treasury Department which interpreted the 1976 Act as allowing the $3000 exemption.[3]

The obvious reason for construing the 1976 Act to embrace the subtraction theory is that the drafters incorporated the Gift Tax law in the Act by excepting "any gift excludable in computing taxable gifts by reason of section 2503(b) (relating to $3000 annual exclusion for purposes of the

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1. Ceppi v. Commissioner 698 F2 17
2. Appendix 7
3. Appendix 8 & 9

tax. . .". Section 2503(b) of the gift tax law has always allowed the $3000 exclusion for gifts in excess of that amount. The government's argument calls for a different construction of Sec. 2503(b) depending on whether the donor lived for 3 years after the gift. The government contends the language of 2503(b) means that in the case of a $6300 gift the $3000 is excludable if the donor lives for 3 years but if he dies within 3 years the same language means the exclusion would not be allowed. When the 1976 Congress incorporated the Gift Tax law in the Act by reference the presumption is that it intended it to be construed as it had always been construed.[1]

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1. The construction of the 1978 Amendment advocated by the Defendant is inconsistent with the general trend toward liberalization of the Estate and Gift tax laws. The Tax Reform Act of 1976 unified the Estate and Gift Tax laws by providing for a combined gift and death tax exemption equivalent to $120,667.00 beginning in 1977 with substantial annual increases to $600,000.00 in 1987. In 1981 Congress further liberalized the law by increasing the annual gift tax exclusion in Sec. 2503 from $3000 to $10,000 and also provided for an unlimited marital deduction. In addition, in 1981 Congress provided that Sec. 2035(a) would not apply to the estates of deced-

The 1978 Technical Amendment can only be justified on the basis of ambiguity in the 1976 Act. There was no need for the 1978 clarifying amendment if there was no ambiguity.

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ents dying after December 31, 1981 which meant that no gift made within 3 years of death would be includable in the deceased donor's estate. The repeal of the provision which provided for a separate rule for gifts made within 3 years of death is consistent with the "subtraction" concept. The 1976 Tax Reform Act unified the Gift and Estate Tax laws and provided the same exemption and tax rates for lifetime gifts and gifts resulting from intestacy or wills. The exemption (in the form of a tax credit) is a lifetime exemption and can be used up by making lifetime gifts or testamentary gifts or a combination of both. This being the case there is no need for a separate provision for gifts made within 3 years of death. Gifts made one day before death are subject to be reported on a gift tax return in the same manner as a gift made 10 years before death and where the gift exceeds the amount of the annual exclusion the tax on the amount over the exclusion is credited against the total exemption regardless of the time when the gift is made. When the 1981 Congress repealed the separate provision relative to gifts made within 3 years of death it reaffirmed its intent that the subtraction concept was to apply to all lifetime gifts including those made within 3 years of death.

The interpretation of the 1978 Congress that the 1976 Act was ambiguous is not controlling. The final responsibility of interpreting the law and ascertaining the intent of Congress rests with the Courts and not the opinions of subsequent Congress's. S.E.C. v. Sloan 436 U.S. 103, 56 L ed 2d 148; Andrus Shell Oil Co., 446 U.S. 657, 666 N. 8 56 L ed 2d 918; Ceppi v. Commissioner 698 F 2d 17, Cert denied.

Statutes are construed by the Courts with reference to the circumstances existing at the time of the passage. United States v. Wise 370 U.S. 405, 8 L ed 2d 500, 82 S Ct 1354. The circumstances surrounding the passage of the 1978 Act do not indicate an intent on the part of Congress to retroactively deprive Mrs. Hancher of the benefits of the 1976 Act in the event the courts held it was the intent of the 1976 Congress to allow the $3000 deduction.

The technical and clarifying purpose behind the 1978 Amendment was called to the attention of the Appeals Court in the present case but the Seventh Circuit in its opinion treated the 1978 Amendment as a substantive change and cited the Ceppi case as its authority.[1] The opinion in the Ceppi case does not consider whether Congressional intent was limited to that of clarification of the supposed ambiguity in the 1976 Act at the time the 1978 amendment was passed. This point apparently was not raised by the briefs of the parties in that case and without discussing the subject the court considered the 1978 Technical Amendment as an intention by Congress to make a substantive change with a retroactive effective date going back 22 months.

The effect of the Appeal's Court ruling is to hold that Congress intended a substantive change in the law when it passed the clarifying amendment. The decision not only does not conform to the circumstances

1. Appendix 16

existing at the time the amendment was passed but it puts Congress in the unfavorable light of enacting a substantive change in the law under the guise of a Technical Amendment.

One of the fundamental rules of statutory construction is that courts will favor a construction which avoids Constitutional issues. Reinecke v. Northern Trust Co., 278 U.S. 339, 73 L ed 410, 49 S Ct 123. The Reinecke case involved the retro-active effect of the Estate Tax law on two types of trusts, both of which were created prior to the passage of the Act. The court held that in the case of trust in which the settlor reserved the power to revoke or change the beneficiary the title to the trust assets did not pass until the settlor's death and there was therefore no constitutional question of deprivation of property without due process of law. In the second type of trust the settlor did not have the exclusive power to revoke or change beneficiary and could only do so with the consent of the beneficiary. The court held that for all practical purposes, title passed to the beneficiary at the time the trust was created and since the Estate Tax Act was passed after the creation of the trust the

constitutional question of due process under the 5th Amendment was raised. The Court held that it was obligated to hold the act was not intended to operate retro-actively in the case of the second type of trust and followed the rule of adopting a construction which would avoid the constitutional issue.

The constitutional question raised earlier in this Petition can be avoided by adopting the ruling of the First Circuit in the Ceppi case holding the 1976 act was not ambiguous and that the 1976 Congress intended the "subtraction theory" and by adopting that which the Plaintiffs and Defendant agree on, namely, that the 1978 Act was intended by Congress to be nothing more than a clarifying amendment and not a substantive change in the law.

THE CLASSIFICATION IN THE 1979 TECHNICAL CORRECTIONS ACT IS ARBITRARY AND UNREASONABLE AND VIOLATES THE DUE PROCESS CLAUSE OF THE FIFTH AMENDMENT TO THE UNITED STATES CONSTITUTION.

After the retro-active 1978 amendment was passed Congress recognized the hardship which it created on those who had made gifts

in reliance on the 1976 Act and passed the 1979 Technical Corrections Act which amended the same section. This amendment provided that Sec. 2035(a) which required the inclusion in the taxable estate of all gifts within 3 years of death would not apply

> "(2) to any gift to a donee made during 1977 to the extent of the amount of such gift which was excludable in computing taxable gifts by reason of Section 2503(b) (relating to $3000 annual exclusion for purposes of the gift tax) determined without regard to Section 2513(a)."[1]

The reasons for the 1979 Amendment were referred to in the Senate Finance Committee Report (1980 U.S. Code Cong. Ad. News Vol. 2, 395) as follows:

> "REASONS FOR CHANGE--Because of the ambiguity that existed prior to the committee's action on this issue in October, 1977, it is possible that gifts could have been made in excess of $3000 based upon the assumption that only the excess of the value

1. See Appendix 1 for complete text and comparison with 1976 and 1978 amendments.

over $3000 would be included in the gross estate as transfers within 3 years of death. Therefore, the committee believes that the "subtraction out" concept should be allowed with respect to gifts made before the adoption of the clarifying change by the Ways and Means Committee."

The 1979 Amendment indicates an intent on the part of Congress to remedy the injustice caused by the retro-active 1978 amendment to those who had made gifts in reliance on the 1976 Act. The relief which is provided permitted the 1977 year donors who had made gifts in excess of $3000 to deduct the $3000 and only the excess would be included in the taxable estate. Stating it another way, the 1979 Amendment repealed the retro-active operation of the 1978 Act in the case of 1977 donors.

The 1979 Act did not provide the same relief for those 1978 donors who had made

gifts prior to the time the 1978 Act became law on November 6, 1978, such as Mrs. Hancher who made her gifts February 21, 1978.

Plaintiff's contend the classification of taxpayers in the 1979 Amendment which grants relief to the estates of 1977 donors but not to the estates of the pre-November 6, 1978 donors is arbitrary and unreasonable and in violation of the due process clause. The Appeals Court disposed of this point in the Plaintiff's brief in one paragraph in footnote 3 on page 7 of its opinion[1] by stating that the distinction between transfers made before and those made after the House Ways and Means Committee began its consideration of the amendment in 1977 was reasonable. The question of the constitutionality of the 1979 amendment was not considered by the First Circuit in the Ceppi case and apparently was not raised.

The rationale for granting relief to the 1977 donors but not to the pre-November

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1. Appendix 17

6, 1978 donors is that the House Ways and Means Committee in October, 1977, began its deliberations concerning the amendment which later became the 1978 Technical Amendment and Mrs. Hancher and other donors had notice of those deliberations and the possibility the law might be changed retro-actively. The report of the Senate Finance Committee[1] actually goes farther than this and states "Because of the ambiguity that existed prior to the committees action in October, 1977, it is possible" etc., and implies that the supposed ambiguity was legally removed by the action of the Committee in October of 1977 .(emphasis supplied) It is interesting to note that the 1977 Congress did not pass this Committee recommendation and it was not adopted by Congress until one year later in the fall of 1978 and did not become law until the President signed it on November 6, 1978.

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1. Appendix 10

The first obvious inconsistency in the government's argument is that the 1979 Amendment provides relief for the post-October, 1977 donors as well as those who made gifts prior to October. The post-October donors had the same notice of the Committee's recommendation as did the 1978 donors. Yet the post-October 1977 donors were given relief which was denied the 1978 donors.

The principal weakness in the government's argument is the absence of any authority which holds that as a matter of law the individual has notice and is bound by the deliberations of Legislative Committees. The invention of this fiction as a means of justifying retro-active legislation creates serious and far reaching problems. If Mrs. Hancher was deemed to have had legal notice of the deliberations of the Committee in October of 1977 was she not also justified in assuming that Congress did not intend to pass the amendment when it was not included in the 1977

Revenue Act? If Mrs. Hancher was charged with notice of the October, 1977 deliberations of the Committee certainly the same is true of the attorney who advised her in planning her estate. If her attorney was charged with notice of the Committee's deliberations was he not remiss and perhaps guilty of malpractice in not advising her to limit her gifts to $3000? If Mrs. Hancher had notice of the 1977 deliberations of the Committee was this not also true of the Treasury Department at the time it prepared its Instructions for Form 706 and Federal Tax Guide for Survivors, Executors and Administrators 1978 edition?[1] These publications indicated the $3000 exclusion was allowable and made no reference to the Committee's deliberations or the fact that a subsequent Congress might a year later adopt them with a retro-active effective date.

1. Appendix 8 & 9

The government's argument which would put Legislative deliberations and committee reports on the same plane with laws passed by Congress and signed by the President is not new and the same argument was rejected in Untermyer v. Anderson 276 U.S. 440, 72 L ed 645, 48 S Ct. 353 where the court said:

> "The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes--he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken." (72 L ed 647)

The hardship and injustice which is inherent in retro-active legislation is con-

trary to the concept of due process of law and this Court should not condone such legislation on the basis that the individual is chargeable with notice of the deliberations of a Legislative committee. The genesis of this completely new concept of law is a statement which appears in a Legislative Committee report. If this concept is to become law it should do so by an act of Congress and not by means of a committee report indirectly concurred in by judicial decision.

This court should take jurisdiction of this case for the purpose of reaffirming the sound constitutional principles enunciated in Untermyer v. Anderson. The need for a reaffirmation of those principles today is just a great as it was when they were announced in 1924.

CONCLUSION

Petitioners respectfully pray that an Order be entered:

1. Holding the retro-active effective date of the 1978 Technical Amendment to Seccion 2035(b)(2) of the Internal Revenue Code unconstitutional as a violation of the due process clause of the Fifth Amendment to the United States Constitution.

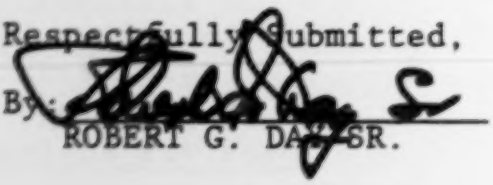
2. Holding that Congress at the time it enacted the retro-active 1978 Technical Amendment to Section 2035(b)(2) of the Internal Revenue Code intended only to make a technical or clarifying amendment on the assumption the 1976 Act was ambiguous and did not allow the $3000 deduction; that Congress did not intend that the 1978 amendment should be construed as a retro-active substantive change in the law in the event it was held the 1976 Act allowed the $3000 deduction and was not ambiguous.

3. Holding that when Congress passed the 1979 amendment it intended to benefit those who were unfairly treated by the retro-

active 1978 amendment; that the classification which benefitted the 1977 donors but not the 1978 donors was arbitrary and unreasonable and in violation of the due process clause of the Fifth Amendment to the United States Constitution.

4. That for any one or all of the foregoing reasons the rulings of the District court and the Appeals Court should be reversed and an Order entered allowing the $3000 exemption for each of the gifts made by Veronica Hancher.

Respectfully Submitted,

By: 
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TRANSFERS DURING LIFETIME

ADJUSTMENTS FOR GIFTS MADE WITHIN 3 YEARS OF DECEDENT'S DEATH

Sec. 2035 (1954 Code). (a) Inclusion of Gifts Made By Decedent.--Except as provided in subsection (b), the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

(b) Exceptions.--Subsection (a) shall not apply

1976 Act (P.L. 94-455) (2) any gift excludable in computing taxable gifts by reason of section 2503(b)(relating to $3000 annual exclusion for purposes of the gift tax) determined without regard to section 2513(a).

1978 Act (P.L. 95-600) (2) to any gift to a donee made during a calendar year if the decedent was not required by section 6019 to file any gift tax return for such year with respect to gifts to such donee.

1979 Act (P.L. 96-222) (2) to any gift to a donee made during 1977 to the extent of the amount of such gift which was excludable in computing taxable gifts by reason of section 2503(b) (relating to $3000 annual exclusion for purposes of the gift tax) determined without regard to section 2513(a).

CHRONOLOGICAL STATEMENT OF EVENTS ALLEGED IN COUNT I

JANUARY 1, 1977 - Effective date of Tax Reform Act of 1976, amending Sec. 2035, excluding from donor's taxable estate $3000 per donee, per year, on gifts made within three years of death.

FEBRUARY 21, 1978 - Veronica made gift of $6,298.00 to each of her seven children.

NOVEMBER 6, 1978 - 1978 Technical Amendment signed by President, amending Sec. 2035, requiring that entire amount of gift be included in taxable estate, if gift required the filing of a Gift Tax Return, (i.e. it was over $3000). This Act retroactively applied to all gifts made after January 1, 1977.

DECEMBER 2, 1978 - Veronica M. Hancher died.

AUGUST 24, 1979 - Veronica's Federal Estate Tax Return filed, reporting the February 21, 1978 gifts of $6,298.00 to each of her seven children, deducting $3000 in exclusions from each gift, and including a

total of $23,090.00 in the taxable estate.

APRIL 1, 1980 - Enactment of the 1979 Technical Amendment which provided that donors who made gifts during the year 1977 only and died within three years could exclude the first $3000 from the taxable estate. (Although known as the Techncial Corrections Act of 1979, it was not approved until April 1, 1980).

TITLE VII TECHNICAL CORRECTIONS OF THE TAX REFORM ACT OF 1976

Sec. 701 Technical amendments to income tax provisions and administrative provisions.

Sec. 702 Technical, clerical and conforming amendment to estate and gift tax provisions.

Sec. 703 Corrections of punctuation spelling, incorrect cross references, etc.

(f) CLARIFICATION OF THE $3,000 ANNUAL EXCLUSION FROM THE RULE INCLUDING IN GROSS ESTATE TRANSFERS WITHIN 3 YEARS OF DEATH-

(1) AMENDMENTS OF SECTION 2035(b)-- Subsection (b) of section 2035 (relating to adjustments for gifts made within 3 years of decedent's death) is amended to read as follows:

"(b)EXCEPTIONS--Subsection (a) shall not apply--

"(1) to any bona fide sale for an adequate and full consideration in money or money's worth, and

"(2) to any gift to a donee made during a calendar year if the decedent was not required by section 6019 to file any gift tax return for such year with respect to gifts to such donee.

Paragraph (2) shall not apply to any transfer with respect to a life insurance policy."

(2) EFFECTIVE DATE- The amendment made by paragraph (1) shall apply to the estates of decedents dying after December 31, 1976, except that it shall not apply to transfers made before January 1, 1977.

As discussed, supra, Congress therefore found it necessary to clarify Code Section 2035(b)(2) in the Revenue Act of 1978 so as to make it clear that only the "de minimus" method of computing the exclusion was permissible. Section 702(f)(1). Revenue Act of 1978, supra.

Congress gave every indication that its enactment of the 1978 amendment was in the nature of a clarification, as opposed to a change in the law. The amendment appeared under Title VII of the Revenue Act of 1978 (labelled "Technical Corrections of the Tax Reform Act of 1976") in a section entitled "Technical, Clerical and Conforming Amendments to Estate and Gift Tax Provisions."10

10. Section 702, Revenue Act of 1978, supra.

In addition, the heading of the amendment itself was "Clarification of the $3000 Annual Exclusion From the Rule Including in Gross Estate Transfers within 3 Years of Death."[11] (Emphasis added.) These labels are proper tools for inferring legislative intent, 2A J. Sutherland, Statutes and Statutory Construction, Secs. 47.03 at 73 and 47.14 at 93-94 (4th ed. 1982), and, as such, they are persuasive indicators that Congress intended the 1978 amendment to correct or clarify its 1976 action in a manner consistent with its legislative intent. Consequently, the clarifying language of the 1978 amendment controls the original as well as the later version of the law. See Dawson Chemical Co. v. Rohm & Hass Co.,448 U.S. 176, 202-203, 213 (1980); Austin v. United States, 611 F 2d 117, 119 (5th Cir. 1980).

11. Section 702(f)(1), Revenue Act of 1978, supra. See also, Section-by-Section Summary of the Revenue Act of the 1978, etc. (Joint Committee) (95th Cong., 2d Sess. (Nov. 17, 1978), at 69)(footnote omitted):

> The Act makes numerous technical, clerical, conforming, and clarifying amendments with respect to provisions enacted by the Tax Reform Act of 1976. In general, each acendment (sic) is effective as of the effective date for the respective provision for the 1976 Act.

JOINT COMMITTEE EXPLANATION

Under the rule for transfers made within 3 years of death, an exception is provided for transfers for an adequate and full consideration in money or money's worth. Generally the inclusion rule will only apply to transfers treated as gifts for gift tax purposes. In addition, another exception is provided on the basis of administrative convenience so that the amount of gifts included is limited to the excess of the estate tax value over the amount excludible with respect to the gifts under the $3,000 annual gift tax exclusion.

In determining the amount of the gross estate, the amount of gift tax paid within 3 years of death is to be includible in a decedent's gross estate. This "gross-up" rule for gift taxes eliminate

GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, JOINT COMMITTEE ON TAXATION, 529, 1976-3 VOL. 2 C.B. 1, p. 541.

Instructions for Schedule G.--
Transfers During Decedent's Life

(1)(a) Transfers made within 3 years of decedent's death.--Transfers by decedents are, unless shown to the contrary, deemed to have been made in contemplation of death, if they were made before January 1, 1977, and within 3 years prior to death. However, no transfer made before January 1, 1977, and more than 3 years immediately preceding the decedent's death shall be deemed a transfer in contemplation of death.

(b) Transfers by decedent after December 31, 1976, and within 3 years of death (in excess of the amount excludable under section 2503(b) determined without regard to section 2513(a)) and the gift tax paid by decedent or estate on any gift made by decedent or spouse within this period are includable in the gross estate.

(2)(a) Transfers made on and after September 8, 1916, taking effect at the decedent's death.

The foregoing material appears on page 8 of Instructions for Form 706.

The transfer of property before 1977 for less than full consideration within 3 years before the death of the decedent is deemed to be in contemplation of death, unless it can be shown otherwise, and the value of such property is included in the gross estate of the decedent.

Note. These provisions do not apply to any portion of such transfers that were excludable in computing taxable gifts through the annual exclusion of the first $3,000 of gifts made to any one donee during a calendar year.

Proceeds of life Insurance. Under most circumstances, the proceeds of a life insurance policy, including accidental death policies are required to be included in the gross estate, even if they were paid directly to the named beneficiary by the insurance company. Part 1 of Form 712, Life Insurance Statement, prepared.

The foregoing material appears on page 16 of Federal Tax Guide For Survivors, Executors, and Administrators, 1978 Edition.

f. Estate tax treatment of gifts made within 3 years of death (sec. 107(a)(2)(F) of the bill and sec. 2035 of the Code)

The Technical Corrections bill, which was added to the 1978 Act, clarified the exception so that only gifts (other than transfer with respect to a life insurance policy) which were made within 3 years of death and were not required to be included in a gift tax return were not to be included in a decedent's gross estate. Under this rule, the entire amount of the gift (and not just the excess of the value of the gift over $3,000) is includable in the gross estate where the aggregate annual gifts to a donee were in excess of $3,000. This clarification was to apply to gifts made after December 31, 1976.

Reasons for Change

Because of the ambiguity that existed prior to the committee's action on this issue in October, 1977, it is possible that gifts could have been made in excess of $3,000 based upon the assumption that only the excess of the value over $3,000 would be included in the gross estate as transfer within 3 years of death. Therefore, the committee believes that the "subtraction out" concept should be allowed with respect to gifts made before the adoption of the clarifying change by the Ways and Means Committee.

Explanation of provision

The amendment allows executors of decedents to elect with respect to all gifts made in 1977 (other than transfer with respect to a life insurance policy) to all donees to include in the decedent's gross estate.

U.S. Code Cong. & Administrative News Vol. 2
1980 96th Congress 2nd Session. pg. 395

In the

United States Court of Appeals

For the Seventh Circuit

No. 83-3156

VALERIA REED & MARCELLA ROULAND, Co-Executors of the Estate of Veronica M. Hancher, deceased, and in behalf of all others similarly situated,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

Appeal from the United States District Court
for the Central District of Illinois.
No. 82 C 1023—**Michael M. Mihm**, *Judge.*

ARGUED APRIL 6, 1984—DECIDED AUGUST 24, 1984

Before BAUER, ESCHBACH, *Circuit Judges*, and JAMESON, *Senior District Judge.**

BAUER, *Circuit Judge.* Plaintiffs, the executors of the estate of Veronica M. Hancher, seek a refund of $21,513.14 in additional federal estate taxes assessed by the Internal Revenue Service (IRS) against the decedent's estate. The district court denied Plaintiffs' claim for refund and granted the government's motion for summary judgment. We affirm.

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* The Honorable William J. Jameson, Senior District Judge, United States District Court of Montana, is sitting by designation.

Veronica Hancher died on December 2, 1978. On audit of the Federal Estate Tax Return filed by the executors of her estate, the IRS assessed additional taxes on the ground that the executors miscalculated the decedent's total taxable estate. The executors paid the assessment and filed for a refund with the IRS. The IRS disallowed the claimed refund and the present action followed.

I. BACKGROUND

On February 21, 1978, Veronica Hancher made a gift to each of her seven children in the form of a house in Florida. The property was valued at $44,090, which resulted in a gift of $6,298.57 to each child. In preparing the decedent's estate tax return, the executors reflected this transfer as part of the decedent's gross estate as required by the Internal Revenue Code (Code) for gifts made within three years of death. *See* 26 U.S.C. § 2035 (1979 & Supp. 1984). Pursuant to the executors' interpretation of § 2035, however, $21,000 ($3,000 per child) was deducted from the total value of the house. This interpretation employs the "subtraction-out" method under which the first $3,000 of each gift is excluded from the total value of the donor's estate, regardless of the total value of the gift. As a result, only $23,090 out of the property's total $44,090 value was included in the decedent's gross estate. Under this method, the remaining $21,000 value would pass to the transferees untaxed.

On audit, the IRS disallowed the $21,000 claimed exclusion. According to the IRS, § 2035 provides for a "de minimus" approach to determining the portion of a gift which may be excluded from a decedent's gross estate. Under this approach, only gifts not in excess of $3,000 are excludable. Because the value of the gift to each child exceeded $3,000, the entire amount of the gift was included by the IRS in calculating the decedent's total estate. The district court held that the IRS properly applied the de minimus method in calculating the decedent's taxable estate. Plaintiffs' first argument on appeal challenges this determination.

The second issue raised by Plaintiffs on appeal challenges the method by which the IRS calculated the credit applicable to the decedent's estate for taxes paid on property she inherited from her deceased husband, Andrew Hancher. Andrew pre-deceased Veronica by sixteen months, leaving her property valued at approximately $435,000, of which $336,500 qualified for a marital deduction. Section 2013 of the Code sets out a formula for determining the amount of the allowable credit. Under this section, the value of the property transferred to a decedent is adjusted for taxes and other obligations incurred with respect to the transferor's estate. *See* 28 U.S.C. § 2013(d) (1979). In calculating Veronica's estate tax, the executors adjusted the value of the property she received by reference to only those taxes and obligations chargeable to the non-marital portion of her inheritance. The credit claimed was $19,366. The IRS allowed only $8,310 of the credit on the ground that all encumbrances relating to Veronica's inheritance, marital as well as non-marital property, had to be deducted from the value of the property she received. The district court upheld the view of the IRS, finding its position supported by the language and intent of § 2013, and sustained its adjustment to the Plaintiffs' claimed credit.

The final issue raised by Plaintiffs in this appeal involves whether the decedent's estate is entitled to claim the full amount of the § 2013 credit for the taxes paid on Andrew's estate even though a portion of the tax liability on his estate remained unpaid at the time of the decedent's death. Andrew's estate elected to pay one portion, that of Andrew's son Bernard, in installments over a ten-year period. *See* 28 U.S.C. § 6166 (1979 & Supp. 1984). At the time the decedent's estate tax return was filed, all but Bernard's portion of the tax on Andrew's estate had been paid. Plaintiffs assert that the decedent's estate is entitled to the entire amount of the § 2013 credit because her share of the tax liability had been satisfied by her estate. Conversely, the IRS concluded that Veronica's estate is not entitled to the full credit until the entire

tax assessment against Andrew's estate has been collected. The district court held in favor of the IRS noting that the estate can recover the disallowed credit as each installment toward Andrew's tax balance is made. *See* Rev. Rul. 83-15, 1983-1 C.B. 224.

II. SECTION 2035

Beginning with the Revenue Act of 1916, inter vivos transfers of property made in anticipation of the transferor's death have been subject to estate taxation. This rule was designed to prevent the avoidance of taxation on the full value of a decedent's estate by the transfer of property out of the estate prior to death. *See Milliken v. United States*, 283 U.S. 15, 20 (1930). Under Code § 2035, the value of any property transferred by the decedent within three years of death is included in the decedent's taxable estate. 28 U.S.C. § 2035(a) (1976). Subsection (b), however, provided an exception to this general rule of inclusion for "any gift excludable in computing taxable gifts by reason of section 2503(b) (relating to $3,000 annual exclusion for purposes of the gift tax). . . ." *Id.* § 2035(b)(2). Because Congress later determined that this section created an ambiguity as to when the $3,000 gift exclusion was allowable, this section was amended in 1978 to provide that the subsection (b)(2) exception is applicable only to transfers "made during a calendar year if the decedent was not required by section 6019 to file any gift tax return for such year. . . ." 26 U.S.C. § 2035(b)(2) (1979). *See* S. Rep. No. 498, 96th Cong., 2d Sess. 86-87, *reprinted in* 1980 U.S. Code Cong. & Ad. News 316, 335. Accordingly, this section clearly mandates application of the de minimus approach, and thereby requires the entire amount of a pre-death transfer to be included in the gross estate if the value of the gift exceeds the amount designated for the filing of a gift tax return. At the time relevant to this appeal, that amount was $3,000.[1] This

[1] Section 2503(b) was subsequently amended to increase the annual gift tax exclusion to $10,000 per donee for gifts made after December 31, 1981. *See* 28 U.S.C. § 2503 (Supp. 1984).

amendment, although signed into law on November 6, 1978, was originally given retroactive effect to January 1, 1977. The Technical Corrections Act of 1979 subsequently amended the retroactive date by allowing the election of the subtraction-out method for transfers made during 1977.[2]

Plaintiffs first contend that the 1976 version of § 2035 provided for the exclusion of $3,000 per gift, in accordance with the subtraction-out approach. Because this was the provision in effect at the time decedent made the gift to her children, Plaintiffs assert that this approach should be allowed in calculating decedent's gross estate. Plaintiffs argue that Congress enacted the 1978 amendment under the mistaken belief that the 1976 provision adopted the de minimus method and that it intended, through the amendment, only to clarify the language of the section. Thus, Plaintiffs urge us to find the 1978 amendment invalid on the ground that the effect of the provision, a change in the substantive law, was not the result Congress intended. In contrast, the IRS asserts that the 1976 version of § 2035 provided for the de minimus approach and that the 1978 amendment merely clarifies this provision. The district court sustained the view of the IRS to the extent that the plain language of the 1978 amendment provides for the de minimus approach and that its application to decedent's estate was proper.

We note initially that Plaintiffs' burden in challenging the validity of a tax provision is substantial. Congress exercises broad discretion in implementing taxes and a strong policy exists against invalidating tax statutes. *See Magnano Co. v. Hamilton*, 292 U.S. 40, 44 (1933); *Barclay & Co. v. Edwards*, 267 U.S. 442, 450 (1924); *Danly Ma-*

[2] The legislative history indicates that this amendment was enacted in response to Congress's view that § 2035 gifts may have been made prior to committee action in 1977 upon the expectation that only the amount in excess of $3,000 would be included in the taxable estate. *See* S. Rep. No. 498, 96th Cong., 2d Sess. 86-87, *reprinted in* 1980 U.S. Code Cong. & Ad. News 316, 395.

chine Co. v. United States, 492 F.2d 30, 33 (7th Cir. 1974); *Lewis v. Regan*, 516 F. Supp. 548, 553 (D. D.C. 1981); *DiPortanova v. United States*, 690 F.2d 169, 180 (Ct. Cl. 1982). Where the language and intent of the statute is clear, courts are without the authority to engage in any creative rewriting of a provision. *See Home Mutual Ins. Co. v. Commissioner*, 639 F.2d 333, 339, 349 (7th Cir. 1980).

In deciding this issue, we need look no further than the current statutory language and its relevant legislative history. The language of the 1978 amendment and its history clearly indicates Congress's intention that the de minimus approach be applied in calculating the allowable estate tax exclusion under § 2035. *See* 28 U.S.C. § 2035 (1979); Joint Committee, 95th Cong., 2d Sess., General Explanation of the Revenue Act of 1978, at 69 (1979). While it may have been the intent of Congress under the 1976 provision to allow the subtraction-out method of computation, the 1978 enactment articulates without question Congress's desire that this method not be employed. *See* 28 U.S.C. § 2035 (1979); S. Rep. No. 498, 96th Cong., 2d Sess. 86-87, *reprinted in* 1980 U.S. Code Cong. & Ad. News 316, 395. We find the clear language of the amendment to be controlling, and therefore, determining the proper method of calculation set forth in the 1976 Code is a task we need not undertake. *See Estate of Ceppi v. Commissioner*, 698 F.2d 17 (1st Cir. 1983) (despite finding subtraction-out method proper under the 1976 Code, court applied de minimus approach retroactively to transfer made January 5, 1978), *cert. denied*, 103 S. Ct. 3088 (1983). To accept Plaintiffs' assertion that the 1978 amendment is invalid would require this court to substitute its judgment for that of Congress and rewrite the wording of the statute. Indeed, Plaintiffs cite no cases in which a court has invalidated the unambiguous wording of an amendment on the ground that it is contrary to the intent behind the previous taxing provision, and we decline to set such a precedent here. *See Renick's Estate v. United States*, 687 F.2d 371 (Ct. Cl. 1982) (express provisions of

Code cannot be disregarded by courts conceiving of fairer interpretation).[3]

Plaintiffs' next contention is that the retroactive application of the 1978 amendment is unconstitutional. The IRS asserts that no constitutional infirmity exists in the retroactive application of the amendment and the district court upheld the IRS's view. We agree. A mere change in an existing tax, as opposed to the creation of an entirely new tax, is not unconstitutional *per se*. *See United States v. Darusmont*, 449 U.S. 292 (1981) (per curiam); *Milliken v. United States*, 283 U.S. 15 (1931). *See also Estate of Ceppi v. Commissioner*, 698 F.2d 17 (1st Cir. 1983). Retroactive features are applied to revenue statutes as a matter of customary congressional practice. *See Darusmont*, 449 U.S. at 296-97. Further, as the *Milliken* Court stated, a taxpayer assumes the risk that the tax burden on a particular transaction may increase pursuant to Congress's continual responsibility to carry out the necessary policies of taxation. 283 U.S. at 23. In accordance with established precedent, we find no constitutional defect in the retroactive application of the 1978 amendment to § 2035. The amended provision did not create a new tax but rather increased the amount of the gift which would be included in the decedent's gross estate. We do not find this type of change to be so harsh or oppressive

[3] Additionally, Plaintiffs argue that the 1979 Technical Corrections Act which allowed the election of the subtraction-out method for transfers made during 1977 should be construed to allow the same choice in regard to transfers made during 1978. They contend that the classification distinguishing between gifts made in 1977 and 1978 is arbitrary. Congress has wide latitude, however, to determine whom to tax and it may draw distinctions between similar classes if such distinctions are reasonably related to a legitimate governmental interest. *See Barclay & Co. v. Edwards*, 267 U.S. 442, 450 (1924); *Danly Machine Co. v. United States*, 492 F.2d 30, 33 (7th Cir. 1974). Committee action on the 1978 amendment began in late 1977, therefore the distinction between transfers made during 1977 and those made in 1978, clearly after committee action had begun, is reasonable.

as to be invalid. Because the transaction at issue has been taxed since the Revenue Act of 1916, the decedent should have known at the time she made the gift that at least some portion of the home's value would be includable in her estate. This is not a situation in which the taxpayer had no reason to believe that the transaction would be subject to taxation at all, but simply a situation in which the transaction is now being taxed to a greater extent. *See Darusmont*, 449 U.S. at 298, 300; *Cohan v. Commissioner*, 39 F.2d 540, 545 (2d Cir. 1930).

Plaintiffs' reliance on *Untermyer v. Anderson*, 276 U.S. 440 (1928) and similar cases as dispositive of this appeal is misplaced. *See Helvering v. Helmholz*, 296 U.S. 93 (1935); *White v. Poor*, 296 U.S. 98 (1935); *Reinecke v. Northern Trust Co.*, 278 U.S. 339 (1929); *Blodgett v. Holden*, 275 U.S. 142 (1927); *Nichols v. Coolidge*, 274 U.S. 531 (1927). Each of these cases involved the retroactive application of taxes to irrevocable transfers made prior to enactment of the taxing statute. As explained above, this is not the situation in the present case. We find the cited cases inapplicable where, as here, the transaction in question was clearly subject to taxation at the time made.[4]

III. SECTION 2013

Pursuant to 28 U.S.C. § 2013(a) (1979), a decedent's estate is credited for all or part of the federal estate taxes paid on property transferred to the decedent from the

[4] Finally, Plaintiffs contend that the decedent should not be held to have known of the impending legislative change at the time she made her transfer. This claim is without merit. If personal notice is even relevant to a constitutional challenge, we find that decedent is in fact chargeable with such knowledge on the basis that the 1978 amendment had been under consideration by Congress since October of 1977, one year prior to its enactment and three months prior to the transfer. *See United States v. Darusmont*, 449 U.S. 292, 299 (1981) (per curiam); *Estate of Ceppi*, 698 F.2d 17, 21-22 (1st Cir. 1983).

estate of a person who died within the ten years preceding or two years subsequent to the decedent's death. The purpose of this section is to avoid diminution of an estate by successive estate taxation on the same property within a relatively short period of time. *See* H.R. Rep. No. 1337, 83d Cong., 2d Sess. 90, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4017, 4452; S. Rep. No. 1622, 83d Cong., 2d Sess. 463, *reprinted in* 1954 U.S. Code Cong. & Ad. News 4621, 5107. The amount of the credit is an amount "which bears the same ratio to the estate tax paid . . . with respect to the estate of the transferor as the value of the property transferred bears to the taxable estate of the transferor . . . decreased by any death taxes paid with respect to such estate. . . ." 28 U.S.C. § 2013(b) (1979). This calculation is expressed in the Treasury Regulations by the following equation:

$$\text{§ 2013 credit} = \frac{\text{value of transferred property}}{\text{transferor's adjusted taxable estate}} \times \text{transferor's adjusted Federal estate tax}$$

Treas. Reg. § 20.2013-2 (1958).

The credit cannot exceed the amount by which the estate tax owed on decedent's estate is greater than the estate which would have resulted if decedent's estate did not include the transferred property. 28 U.S.C. § 2013(c). In determining the amount of the credit, the value of the property transferred is defined by § 2013(d) as:

> . . . the value used for the purpose of determining the Federal estate tax liability of the estate of the transferor but—
>
> (1) there shall be taken into account the effect of the tax imposed by section 2001 or 2101, or any estate, succession, legacy, or inheritance tax on the net value to the decedent of such property;
>
> (2) where such property is encumbered in any manner, or where the decedent incurs any obli-

> gation imposed by the transferor with respect to such property such encumbrance or obligation shall be taken into account in the same manner as if the amount of a gift to the decedent of such property was being determined; and
>
> (3) if the decedent was the spouse of the transferor at the time of the transferor's death, the net value of the property transferred to the decedent shall be reduced by the amount allowed under § 2056 (relating to marital deductions), as a deduction from the gross estate of the transferor.

28 U.S.C. § 2013(d).

In calculating the amount of the decedent's § 2013 credit, Plaintiffs reduced the value of the property transferred from her husband's estate by only those taxes and obligations allocable to the non-marital property she received. Because less than one-fourth of the property transferred to the decedent was non-marital property, the subsection (d)(2) reductions were applied to a relatively small portion of her total inheritance. This, in turn, resulted in a larger credit to the decedent's own estate tax. Plaintiffs claim that because the § 2013 credit was designed to account for those taxes previously paid on the transferred property, only those obligations allocable to the taxable portion of transferor's estate should be included. The IRS asserts that Plaintiffs' position is contrary to the language of the statute. The district court sustained the IRS's interpretation.

The language of § 2013(d) delineates three distinct categories of adjustments to be made in determining the value of the property transferred to a decedent. The adjustment for the transfer of marital deduction property in subsection (d)(3) appears simply as the third category set out. No reference to marital property appears in either category (d)(1) or (d)(2). Therefore, the plain language of § 2013(d) does not support Plaintiff's contention that the subsection (d)(2) adjustment for encumbrances and obligations applies to non-marital property only.

EDITOR'S NOTE

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Furthermore, the legislative history behind § 2013 is instructive. The Senate Report discussing the 1954 Code specifically states that the determination of the property's value under § 2013(d) shall take into account "all encumbrances or obligations." S. Rep. 1622 at 467, *reprinted in* 1954 U.S. Code Cong. & Ad. News at 511. No distinction is made in this reference between marital and nonmarital property. Additionally, the Report states that for purposes of greater certainty, subsection (d) was amended to provide that the value of property transferred to the decedent will be calculated in an identical manner as property passing to a surviving spouse under § 2056, the section providing for the marital deduction. *Id.* In fact, the wording of § 2013(d) mirrors that of § 2056(b)(4). The Treasury Regulations under § 2056(b)(4) specifically provide that if the property passing to the surviving spouse is subject to a mortgage, encumbrance or other obligation, the value of the property must be reduced by such amount prior to the calculation of the marital deduction. Treas. Reg. § 20.2056(b)-4(b) (1958). Thus, only the net value of the transferee's interest may be used in calculating the marital deduction under § 2056. In the same way, only the net value of the property transferred may be used for purposes of determining the allowable § 2013 credit. Other courts have reached this conclusion as well. *See Estate of Sparling v. Commissioner*, 552 F.2d 1340, 1345 (9th Cir. 1977); *Estate of McGauley v. Commissioner*, 504 F.2d 1030, 1032 (2d Cir. 1974). *See also United States v. Stapf*, 375 U.S. 118 (1963) (interpreting corresponding provision in 1939 Code). Accordingly, we find that the credit allowable under § 2013(d) must be determined by reference to all encumbrances or obligations on the decedent's inherited property, not solely those allocable to nonmarital property.

Plaintiffs' final contention is that the IRS erred in denying the decedent's estate the full § 2013 credit it claimed on the ground that the entire tax liability on Andrew's estate had not yet been paid. Plaintiffs claim that denying Veronica's estate the full credit is contrary to the stat-

utory language and simply inequitable. The IRS argues that Plaintiffs' interpretation would allow the estate a credit based, in part, on taxes which are yet unpaid and which ultimately may never be paid in the event of a default. To allow the decedent's estate · · full credit would effectively shift to the government the risk that the remaining taxes due on Andrew's estate may never be paid. Further, the IRS asserts that any unfairness to decedent's estate is eliminated by the application of Revenue Ruling 83-15, 1983-1 C.B. 224, which allows a decedent's estate to file a protective claim for the remaining amount of the credit due and to collect a refund of the proportionate amount of the credit when each installment payment is made. The district court upheld the position of the IRS and we agree.

Plaintiffs argue that because § 2013(a), which provides a credit for "the Federal estate tax paid with respect to the transfer of property . . . to the decedent," does not specifically refer to payment of the entire tax due on the transferor's estate, the section requires only that the tax be paid on the property transferred to the decedent. Yet as discussed above, § 2013 credit represents a proportionate amount of the transferor's adjusted federal estate tax. If the transferee's estate is allowed to take a credit based on taxes yet unpaid, the estate might receive a windfall in the event that no tax is eventually collected. Such a result would defeat Congress's intent to collect taxes on every taxable estate except where double taxation would occur on the same property within a relatively short period of time. *See Shedd's Estate v. Commissioner*, 320 F.2d 638, 640 (9th Cir. 1963).

Furthermore, we note that Plaintiffs' equity concerns are adequately dealt with under Revenue Ruling 83-15. The ruling protects the interests of both the decedent's estate and the IRS pending satisfaction of the prior tax liability. The decedent's estate is not denied its allowable credit, rather its full entitlement is merely postponed.

IV. CONCLUSION

We hold that the 1978 amendment to § 2035 was a proper exercise of Congress's broad taxing authority and that the retroactive application of the amendment under the Technical Corrections Act of 1979 is constitutional. Further, we hold that § 2013 requires a reduction in the value of property transferred to a decedent by those taxes and expenses attributable to both non-marital and marital deduction property. Finally, the § 2013 credit due to the estate of a transferee may only be taken to the extent that the full tax liability on the transferor's estate has been paid. For the above reasons, we affirm the district court's grant of the government's motion for summary judgment.

AFFIRMED.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF ILLINOIS

VALERIA REED and MARCELLA ROULAND, Co-Executors of the Estate of Veronica Hancher, deceased,	)	
Plaintiffs,	)	
v.	)	No. 82-1023
UNITED STATES OF AMERICA,	)	
Defendant.	)	

ORDER

This is an action for a refund of overpayment of federal estate taxes. In Count I, Valeria Reed and Marcella Rouland as Co-Executors of the Estate of Veronica M. Hancher ("Plaintiffs"), claim that $21,000 was erroneously included as a part of the taxable estate of the decedent, and therefore seek a refund of the taxes paid on that amount. On February 21, 1978, Veronica M. Hancher made a gift to her seven children of a home in Florida valued at $44,090. Because under 26 U.S.C. § 2035(b)(2) the estate was arguably entitled to a gift tax exclusion of $3,000 for each of her seven children, the estate excluded $21,000 from

the taxable estate. On November 26, 1978, the President signed into law an amendment of §2035(b)(2) of the Internal Revenue Code which provided that the exclusion in this case would be disallowed. The amendment provides that only gifts which are less than $3,000 in total are excludable for gift tax purposes. The full amount of a gift over $3,000 is includable in the taxable estate. In other words, only "de minimus" gifts are excluded for gift tax purposes, and $3,000 is not "subtracted-out" of larger gifts.

The bill was given retro-active effect to January 1, 1977 and the estate was denied the $21,000 exclusion. Congress later enacted the Technical Corrections Act of 1979 which allowed election of the subtraction-out method for gifts made in 1977. Plaintiffs claim that the retro-active application to gifts made between January 1, 1978 and November 26, 1978 is unconstitutional as an ex post facto law under Article 1, Section 9 of the United States Constitution and invalid under the due process clause of

the United States Constitution. In Count I Plaintiffs request that the complaint be maintained as a class action for the benefit of all federal estate taxpayers who are similarly situated.

Counts II and III involve the computation of the credit for estate tax paid on prior transfers provided for in Section 2013 of the Internal Revenue Code of 1954. In Count II Plaintiffs contend that the valuation of property transferred to Veronica M. Hancher for purposes of the Section 2013 computation should not be reduced by inheritance taxes, property taxes, and other obligations attributable to the marital deduction property. In Count III Plaintiffs contend that the entire estate tax on a prior estate need not be paid in order to allow a party who has paid its share of the tax on the prior estate to claim the credit under Section 2013.

DISCUSSION

Count I

The resolution of the Section 2035(b)(2) issue in Count I turns on the case of Estate of Ceppi, 698 F2d 17 (1st Cir. 1983). The Court in Ceppi, and the parties in their briefs, addressed two separate issues under the Section 2035(b)(2) question; namely, whether as of 1976 Section 2035(b)(2) provided a "subtraction-out" or "de minimus" approach and whether the 1978 amended version could constitutionally be given retro-active effect. However, since it is the opinion of the Court that the 1978 amendment can be given retro-active effect, it is only necessary to address this second issue.

In Ceppi, the First Circuit reaffirmed the principles set out in Milliken v. United States, 283 U.S. 15 (1931) which held that the constitutionality of retro-active application of a tax statute depends on the nature of the particular tax and upon the gift involved. An earlier case denying

retro-active effect of new tax laws, Untermyer v. Anderson, 276 U.S. 440 (1928), was distinguished as standing only for the proposition that a wholly new gift tax cannot be applied retro-actively. The Court in Ceppi, supra, at 21 stated:

> "Under this reading of Untermyer and Milliken, the retro-active application of the 1978 version of §2035(b)(2) is constitutional. In both Milliken and the present case, there was no dispute that the gifts were includable in the gross estate. Moreover, the increase in the estate tax base in this case is closely analogous to the increase in the estate tax rate in Milliken. The practical concern of the donor is the amount of taxes due, and an increase in the tax base has the identical effect as an increase in the tax rate--it increases the amount of taxes due. Thus, the present case falls squarely within Milliken."

Based upon the persuasive authority of Ceppi, it is the judgment of this Court that the 1978 Amendment to 26 U.S.C. §2035(b)(2) can constitutionally be given retro-active effect. Therefore, it was proper for the Internal Revenue Service ("IRS") to apply the "de minimus theory in the calculation

of the estate tax.

(Count II and III are omitted because they are not matters involved in this Appeal)

CONCLUSION

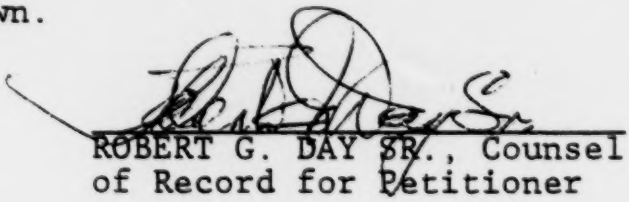
Based on the analysis set out above, it is the judgment of the Court that the Plaintiff's Motion For Summary Judgment on Counts I, II and III of the Complaint are hereby DENIED and the Government's cross motions for summary judgment on Counts I, II and III of the complaint are hereby GRANTED.

ORDER ENTERED: August 9th, 1983.

/s/ MICHAEL M. MIHM
Michael M. Mihm
United States District Judge.

PROOF OF SERVICE

The undersigned ROBERT G. DAY, SR., Attorney of Record for Petitioner, does hereby certify that on the 14TH day of November, 1984, he served three copies of the foregoing Petition for Certiorari upon the Solictor General, Department of Justice, Washington, D.C., 20543 by depositing the same in the United States Post Office, on said date, with postage pre-paid, properly addressed to said party at the address herein shown.



ROBERT G. DAY SR., Counsel
of Record for Petitioner